EAST HERTS COUNCIL

COMMITTEE - AUDIT COMMITTEE – 26 NOVEMBER 2014

REPORT BY EXECUTIVE MEMBER OF FINANCE

TREASURY MANAGEMENT STRATEGY – 2014/15 MID- YEAR REVIEW

WARD(S) AFFECTED: NONE SPECIFIC

Purpose/Summary of Report

- This report reviews the Council's treasury management activities for the 6 months to 30 September 2014.

RECOMMENDATION FOR AUDIT COMMITTEE **That:**	
(A)	**the loan and investment position as at 30 September 2014 be noted; and**
(B)	**the Prudential Indicator position as at 30 September 2014 be noted and that no changes to Prudential Indicators be proposed.**

1.0 Background

1.1 Treasury management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.2 The Council has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code).

1.3 This mid-year report has been prepared in compliance with the Code, and covers the following:

- A brief economic update;
- A review of the treasury position, and the Council's loan and investment portfolio as at 30 September 2014;
- A review of the Council's Treasury Management Strategy;
- A review of compliance with Treasury and Prudential Limits for 2014/15.

1.4 The Council is supported in its treasury management activities by independent advisers – Capita Asset Services.

2.0 Report

2.1 Economic Update

2.2 After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1, 0.9% in Q2 and a first estimate of 0.7% in Q3 2014 (annual rate 3.1% in Q3), it appears very likely that strong growth will continue through 2014 and into 2015.

2.3 However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable.

2.4 Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years.

2.5 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.2% in September, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

2.6 The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

2.7 The U.S. faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

2.8 The Eurozone is facing an increasing threat from weak or negative growth and from deflation. Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return.

2.9 Interest rate forecasts are set out in **Essential Reference paper 'B'.** The impact on the Council of the economic forecast and interest rates predictions is discussed below.

2.10 <u>Treasury position as at 30 September 2014</u>

The Council's treasury management function manages debt and investment to ensure adequate liquidity to fund the revenue budget and the capital programme, and to maximise return on investments given an acceptable and appropriate level of risk. Procedures and controls to achieve these objectives are well established through reporting to Members and through compliance with the Council's Treasury Management Strategy and system of internal control.

2.11 Debt and investment balances as at 30 September 2014 are analysed in tables 1 and 2 in **Essential Reference Paper 'C'**. Approved limits within the Annual Investment Strategy were not breached during the first six months of 2014/15.

2.12 As implied by the economic update section above, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

2.13 The continuing poor economic outlook means that the Council's investment portfolio is expected to underperform against initial expectations. The September Healthcheck estimates that returns will be £794,000 which is £89,000 below the budget forecast for 2014/15 of £895,000. The unfavourable variance will be met from the Interest Equalisation Reserve as agreed by Council. The balance on the reserve is £2.257 million as at 31 March 2014.

2.14 The investment portfolio continues to maintain a relatively high degree of liquidity with the least liquid investments (in-house term deposits) generally rolled over for periods of 1 year.

2.15 <u>Review of the Treasury Management Strategy</u>

2.16 A revised Treasury Management Strategy and Annual Investment Strategy for 2015/16 will be presented to Council in December 2014. An update to the 2014/15 Strategy was presented to Council on 30 July 2014. No further changes to the 2014/15 Strategy are proposed in this report.

2.17 The update to the 2014/15 Strategy presented to Council on 30 July 2014 included criteria for investment in non-treasury investment vehicles such as pooled property funds. It is however not expected that any pooled property fund investment opportunities will arise until summer 2015.

2.18 <u>Review of Compliance with Treasury and Prudential Limits</u>

2.19 The Prudential Indicators approved for 2014/15 have been included in **Essential Reference Paper 'D'**.

2.20 Prudential indicator 1, 2, 3, 4 – capital investment plans and financing:

Capital programme estimates and outturn form part of the monthly Healthcheck report. The Council resolved to fund the capital programme internally rather than from external borrowing. Given the current economic climate it is not proposed that this approach be changed.

2.21 The capital outturn presented in the September Healthcheck report shows that the expected capital outturn will be £165,000 less than the revised estimate. Therefore there is no risk that the 2014/15 capital programme will become unaffordable to the Council.

2.22 Prudential indicators 5, 6, 7, 8, 9 – borrowing:

There has been no change to the Council's outstanding loans. Therefore there is no risk that any of the prudential indicators relating to borrowing will be breached or require reconsideration prior to 2015/16.

3.0 Implications/Consultations

3.1 Information on any corporate issues and consultation associated with this report can be found within **Essential Reference Paper 'A'**.

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